

COMMONWEALTH OF KENTUCKY  
BEFORE THE PUBLIC SERVICE COMMISSION

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In the Matter of:

THE APPLICATION OF SARGENT AND	)	
STURGEON BUILDERS, INC., GARDEN	)	
HEIGHTS SUBDIVISION SEWER DIVI-	)	
SION, FOR A RATE ADJUSTMENT	)	CASE NO. 9128
PURSUANT TO THE ALTERNATIVE RATE	)	
FILING FOR SMALL UTILITIES	)	

O R D E R

On September 10, 1984, Sargent and Sturgeon Builders, Inc., ("Sargent and Sturgeon") d/b/a Garden Heights Subdivision Sewer Division ("Garden Heights"), filed an application with the Commission to increase its rates pursuant to 807 KAR 5:076, Alternative Rate Adjustment Procedure for Small Utilities ("ARF"). The proposed rates would produce additional revenue of approximately \$6,795 over normalized test-year operating revenues, an increase of 50.7 percent. Based on the determination herein, the operating revenue of Garden Heights will increase by \$1,744 annually over normalized test-year operating revenue, an increase of 13 percent.

COMMENTARY

Garden Heights is a privately-owned sewage treatment system organized and existing under the laws of the Commonwealth of Kentucky and serves approximately 115 customers in Daviess County, Kentucky. Garden Heights is owned and operated by Sargent and Sturgeon, a corporation engaged in the business of

developing and managing subdivisions, including the management and operation of the subdivisions' sewage treatment facilities. Sargent and Sturgeon also owns and operates Gardenside Subdivision Sewer Division ("Gardenside"). Due to this affiliation between Garden Heights and Gardenside, the divisions share resources such as labor, management, vehicles, etc.

Concurrent with the filing of this application, Sargent and Sturgeon filed Case No. 9127, The Application of Sargent and Sturgeon Builders, Inc., Gardenside Subdivision Sewer Division, for a Rate Adjustment Pursuant to the Alternative Rate Filing for Small Utilities. Case No. 9127 has been closely coordinated with this proceeding.

Because Garden Heights and Gardenside are mutually-owned companies and share resources, several expenses incurred by Sargent and Sturgeon are related to both sewer divisions and therefore must be allocated to each division. Additionally, Sargent and Sturgeon shut down its construction operations in the summer of 1983 and for this reason certain expenses previously absorbed by that division now must be allocated to the sewer divisions. These mutual expenses have, in general, been allocated based on the number of customers served, which results in an allocation of one-third (115 customers) to Garden Heights and two-thirds (231 customers) to Gardenside.

#### TEST PERIOD

Garden Heights has proposed and the Commission has accepted the 12-month period ending December 31, 1983, as the test period for determining the reasonableness of the proposed

rates. In utilizing the historical test period, the Commission has given full consideration to known and measurable changes found reasonable.

#### REVENUES AND EXPENSES

The ARF was established to provide a simplified and less expensive method for small utilities to apply for rate increases with the Commission. Though superficial accounting errors were numerous, the financial data from the 1983 annual report have been used as the basis for determining revenue requirements. The Commission has accepted Garden Heights' proposed accounting expense in this proceeding. Therefore, in the future, the Commission will expect Garden Heights to file its annual reports prepared in accordance with the Uniform System of Accounts for Class C and D Sewer Utilities.

Garden Heights proposed adjustments to revenues and expenses as reflected in the comparative income statement filed in the revised application. The Commission is of the opinion that the proposed adjustments are generally proper and acceptable for rate-making purposes with the following modifications to reflect actual and anticipated operating conditions:

##### Normalized Revenue

Garden Heights' 1983 annual report reflects 115 customers and operating revenues of \$12,387. Garden Heights stated that test year revenues were reported net of the collection fee charged by Southeast Daviess County Water District; however it further stated that this would not be repeated in the future. In order to normalize annual revenues, the Commission has increased

reported test year revenues by \$1,013 to \$13,400 based on the number of customers and the monthly rate at test year end.

Wages and Salaries

Garden Heights' test-year operating statement reflects that the amount of test-year wages and salaries of T. L. Sargent, manager of Garden Heights, and John Lewis, maintenance man for Garden Heights, allocated by Sargent and Sturgeon to Garden Heights was \$4,732. Garden Heights proposed an adjustment of \$1,833 based on an increase in Mr. Sargent's salary and also an increase in the percentage of wages and salaries allocated to Garden Heights. This results in a proposed wages and salaries expense of \$6,565.

In its information request of October 12, 1984, the Commission requested Garden Heights to provide the total number of regular and overtime hours worked during the test year as well as a complete description of the duties and responsibilities of each employee, manager or owner.

In regard to Mr. Sargent, Garden Heights stated in its response to the Commission's request that,

T. L. Sargent is on call 24 hours per day, handles customers complaints, if any, all record keeping, banking, and office management. He further checks the plants a minimum of one time per week and oversees the performance by John Lewis of the daily maintenance, repair and operation of the treatment plants.

In regard to Mr. Lewis, Gardenside stated,

John Lewis works six hours per day, three in the morning and three in the evening, seven days per week, and is on call 24 hours per day. He checks the plant two times daily, performs all maintenance

and repairs for which he is qualified, tests the effluent, and performs such other duties as required by Mr. Sargent.

With reference to Mr. Sargent's manager's salary, Garden Heights proposed a salary of \$2,600 based on total compensation by Sargent and Sturgeon of \$200 per week allocated 25 percent to Garden Heights. Garden Heights was apprised that "It is the Commission's normal policy to allow a management fee of \$1,800 for small privately owned sewer utilities,"<sup>1</sup> and was requested to "provide any evidence deemed appropriate as to why the Commission should deviate from current policy and allow a larger management fee in this proceeding." Garden Heights responded that "Mr. Sargent has made loans to the corporation in the amount of \$5,000 on April 28, 1982, and \$4,200 on October 5, 1984, neither of which loans have been repaid."<sup>2</sup> However, financial information contained in the 1983 Garden Heights annual report does not indicate any such outstanding debt and no evidence has been presented in this proceeding documenting such loans. Furthermore, Garden Heights filed a statement that "Garden Heights Sewer Division does not have at present any outstanding indebtedness."<sup>3</sup> For rate-making purposes, the issue of whether Mr. Sargent has made loans to Garden Heights or not has no bearing on the

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- 1 Commission's Information Request of December 17, 1984, Item 4.
  - 2 Response, Commission's Information Request of December 17, 1984, Item 4.
  - 3 Response, Commission's Information Request of October 12, 1984, Item 5.

appropriate level of compensation which should be allowed. The subject of debt service is an entirely separate issue and persuasive evidence must be presented, documented and justified by the utility if it proposes that such an expense be allowed for rate-making purposes. The record demonstrates that debt service is not an issue in this proceeding. Moreover, if Mr. Sargent is seeking a return on his investment through his management fee the Commission cannot provide such a return in this fee as well as through the provision of a reasonable rate of return.

Therefore, it is the Commission's opinion that Garden Heights has failed to meet its burden of proof as to why a higher than normal management salary should be allowed in this instance. Therefore, the Commission will allow a \$1,800 management fee, which is the level of expense normally allowed for small investor-owned sewer utilities.

With reference to Mr. Lewis' wages, Garden Heights proposed a wage of \$3,965 based on total compensation of \$305 per week allocated 25 percent to Garden Heights. This level of compensation provides for twice daily inspection of the plant by Mr. Lewis. The final Order in the last Garden Heights rate case, a joint application with Gardenside, dated October 28, 1981, Case No. 8238, Adjustment of Rates of the Sargent & Sturgeon Builders, Inc., states,

The Commission is of the opinion that once-a-day inspections should provide for sufficient maintenance and operation of the treatment plants. . . [and] twice daily inspections are not essential to

an efficient operation and should not be allowed for rate-making purposes herein.<sup>4</sup>

The Commission requested Garden Heights to "provide any evidence deemed appropriate as to why the Commission should allow the expense associated with twice-daily inspections in this proceeding."<sup>5</sup> Garden Heights rested its case on its assertion that,

If the plant is shut down for the possible 23 hours [between trips]. . .[after repaired] it would take from three to four days for the effluent to reach the level which is apparently acceptable to the Department of Health and the Environmental Protection Agency. . .[and would result in] a condition which would adversely affect the health and welfare of the customers. . .[and] create an unhealthy and unpleasant atmosphere in the subdivision.<sup>6</sup>

The argument presented by Garden Heights is true for almost all sewer utilities. This is why the Commission provides revenues to cover the expense of daily maintenance trips to the plant when establishing revenue requirements. A successful maintenance program should reduce the risk of equipment failure to a very slight possibility. Of course, twice daily trips are desirable, three would be better, and, ideally, a maintenance man could be stationed at the plant 24 hours a day. However, in determining a reasonable number of trips, the costs to the customers must be weighed against the benefits. In this proceeding, as evidenced by

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<sup>4</sup> Case No. 8238, Order entered October 28, 1981, page 3.

<sup>5</sup> Response, Commission's Information Request of December 17, 1984, Item 11.

<sup>6</sup> Ibid.

Garden Heights' response, the extra trip is made only to determine whether or not a malfunction of equipment has occurred. No evidence has been provided that there have been frequent equipment failures at the plant, or that there might be. Additionally, other means to alert sewer plant owners of equipment failure may be a reasonable alternative to personal inspections. As no persuasive evidence was presented in this case justifying the additional daily trip, it is the Commission's finding that Garden Heights has not met its burden of proof on this issue, and it has therefore eliminated 50 percent of the proposed wage of Mr. Lewis from operating expenses for rate-making purposes.

Additionally, the final Order in Case No. 8238 states, "[T]he Commission is of the opinion that management and clerical salaries should be allocated based on the number of customers served by Garden Heights to the total customers of both sewage treatment plants."<sup>7</sup> Based on reported test year-end number of customers, one-third of wages and salaries should be allocated to Garden Heights and two-thirds to Gardenside. Therefore, in accordance with that finding, Mr. Lewis' wage has been allocated one-third to Garden Heights and two-thirds to Gardenside. This results in wages for Mr. Lewis allocable to Garden Heights for rate-making purposes of \$2,643.

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<sup>7</sup> Case No. 8238, Order entered October 28, 1981, page 4.



Based on the foregoing, the total wages and salaries expense for Garden Heights used herein for rate-making purposes is \$4,443.

#### Transportation

Included within Garden Heights' test-year operation and maintenance expenses are transportation charges of \$2,085. This amount represents 21,900 miles driven by John Lewis and 3,120 miles driven by Mr. Sargent. Mr. Lewis and Mr. Sargent were reimbursed at a rate of \$.25 per mile and one-third of total travel reimbursements were allocated to Garden Heights. No adjustment to transportation costs was proposed by Garden Heights.

Garden Heights proposed to use \$.25 per mile as the rate for calculating transportation expense in this proceeding. The Commission questioned Garden Heights as to the basis for using this amount as the reimbursement rate. Other than this being the reimbursement rate utilized during the test year, no justification was presented in support of this rate.<sup>8</sup> The current tax standard mileage rate prescribed by the Internal Revenue Code, Code Section 162, is \$.205 per mile. It is the Commission's opinion that \$.205 per mile is a more fair, just and reasonable reimbursement rate for transportation and it has therefore utilized this amount as the basis for determining transportation expense herein.

As discussed in the "Wages and Salaries" section,<sup>9</sup> the

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<sup>8</sup> Response, Commission's Information Request of December 17, 1984, Item 5.

<sup>9</sup> Pages 4-8 of this Order.

necessity of twice daily trips to the treatment plant has not been justified by Garden Heights. Therefore 50 percent of the transportation costs associated with Mr. Lewis' trips to the treatment plant have been eliminated for rate-making purposes.

Additionally, Garden Heights has not supported the need for the weekly trip to the treatment plant by Mr. Sargent. As daily trips to the plant are made by Mr. Lewis, additional visits are unnecessary. Furthermore, the Commission has established as a precedent in many other cases the allowance for managers of sewer utilities of this size, with comparable organizational structure, annual compensation of \$1,800, which includes ordinary travel requirements. Additional compensation, such as for unusual travel expenses to the premises of the plant, etc., must be sufficiently documented and justified. As no persuasive evidence has been presented in this case justifying the additional compensation, it is the Commission's finding that Garden Heights has not met its burden of proof on this issue and it has therefore eliminated Mr. Sargent's test-year transportation costs from operating expenses for rate-making purposes.

In the final Order in Case No. 8238, total Sargent and Sturgeon travel expenses were allocated one-half to Garden Heights and one-half to Gardenside. Therefore, the Commission has used the same method of allocation for determining the appropriate travel expense herein.

Based on the above analysis, the transportation cost found reasonable for rate-making purposes is \$1,122.<sup>10</sup> This amount has been included within operating expenses for the purposes of determining revenue requirements herein.

The Internal Revenue Code, Code Section 274(d), as amended by the Tax Reform Act of 1984 requires taxpayers to keep adequate contemporaneous records to substantiate transportation expense. In regard to future rate cases, the Commission will not allow Garden Heights a transportation expense without adequate contemporaneous records substantiating actual transportation expense for the test year. Therefore, the Commission recommends that Garden Heights keep records of actual mileage and actual expenses incurred in the operation of a motor vehicle while on official utility business.

Other - Labor, Materials, and Expenses/Depreciation

Garden Heights reported test year charges to Account No 701-C -- Treatment System: Other - Labor, Materials, and Expenses of \$2,435. At the Commission's request, Garden Heights provided a breakdown as documentation in support of this amount.<sup>11</sup> An examination of this breakdown indicated that there was a possibility that some items that were expensed by Garden Heights during the test year should have been capitalized to Utility Plant in Service. Therefore the Commission requested copies of the

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<sup>10</sup> 21,900 miles x \$.205 x 1/2 (allocation to Garden Heights) x 1/2 (elimination of 1 daily trip) = \$1,122.

<sup>11</sup> Response, Commission's Information Request of October 12, 1984, Item 6.

invoices associated with these expense items.<sup>12</sup> A review of these invoices indicated that a \$960 expenditure for a chlorinator (McCoy and McCoy, Inc., Invoice 65258 dated September 23, 1983) was improperly charged to Operations Supplies and Expenses during the test year. As this expenditure will provide benefits for more than one accounting period, it is the finding of the Commission that this expenditure should be capitalized and depreciated at a rate of 10 percent annually. Therefore, Other - Labor, Materials and Expenses has been reduced by \$960 and depreciation expense increased by \$96 for the purpose of determining revenue requirements herein.

#### Other Expenses

Garden Heights reported test year charges to Account No. 700-B -- Other Expenses of \$702 and proposed a \$1,298 adjustment. In its application Garden Heights stated that the basis for this adjustment was that due to "the shutdown of the construction element of Sargent and Sturgeon Builders, Inc., certain expenses previously paid by the Corporation now must be absorbed" by Garden Heights and Gardenside. As little detail and evidence was presented in the initial application concerning this adjustment, the Commission requested Garden Heights to "[E]xplain the pro forma adjustment in detail and provide any evidence or other documentation available in support of the adjustment," and to "[P]rovide a list of the specific expenses previously absorbed by

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<sup>12</sup> Response, Commission's Information Request of December 17, 1984, Item 6.

the construction company and the amounts incurred during the test year."<sup>13</sup> Garden Heights' responses to these requests were inadequate to support the proposed adjustment. The response stated that this "is the amount of hazard insurance, including public liability, which is allocated to this sewer division;"<sup>14</sup> however, no documentation was presented to support this expense as requested by the Commission. To allow a proposed adjustment the Commission must be presented with evidence demonstrating that the adjustment is related to a known and measurable event. As Garden Heights did not meet its burden of proof on this issue, the Commission has excluded the proposed adjustment for rate-making purposes herein.

#### Electricity Expense

Garden Heights reported test year electricity expense of \$1,262 and proposed an adjustment of \$282 based on advice from representatives of its supplier, Green River Electric Cooperative ("GREC"), that it is anticipated that the rate charged for electricity will increase 15 percent over the next 2-year period. Whereas the Commission does currently have pending before it an application by GREC to flow through a proposed wholesale rate by its supplier, Big Rivers Electric Corporation, that proceeding has yet to be resolved and any adjustment made in anticipation of its outcome would be arbitrary and speculative. As the result of that

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<sup>13</sup> Ibid., Item 3.

<sup>14</sup> Ibid.

case is not a known and measurable event, the Commission will not allow Garden Heights' proposed adjustment for rate-making purposes.

In order to document actual test year electricity expense, the Commission requested copies of 1983 electricity bills. Based on its review of these bills the Commission has determined that the actual test year electricity expense was \$1,428. Therefore an adjustment of \$166 has been made to reflect the actual expense incurred by Garden Heights during the test period.

#### Water Expense

Included within Garden Heights' proposed adjustment to Account No. 703 -- Fuel and Power Purchased for Pumping and Treatment is \$65 for water expense. During the test year this expense had been absorbed by the construction operations of Sargent and Sturgeon and therefore no test year actual water expense was reported.

At the Commission's request, Garden Heights provided copies of test year water bills.<sup>15</sup> The bills reflect an actual test year expense of \$102. Therefore, the Commission has allowed an adjustment of \$102 to water expense for rate-making purposes.

#### Sludge Hauling

Garden Heights reported test year sludge hauling expense of \$780. In order to document this level of expense the Commission requested copies of 1983 sludge hauling invoices. In response to

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<sup>15</sup> ibid., Item 7.

this request Garden Heights provided copies of C.G. Williams Septic Tank Service invoices totaling \$240.<sup>16</sup> In response to a Commission request to explain the discrepancy between reported sludge hauling expense and the invoice totals, Garden Heights responded that "the copies of the invoices for sludge hauling are correct."<sup>17</sup> Therefore, the Commission has used \$240, the amount of the invoices, as the level of sludge hauling expense for rate-making purposes herein.

#### Taxes Other Than Income Tax Expense

Garden Heights proposed an adjustment of \$332 to Account No. 408.1 -- Taxes Other Than Income Taxes based upon its proposed level of wages and salaries. In accordance with the wages and salaries expense found reasonable in the section, "Wages and Salaries,"<sup>18</sup> and based upon current state and federal unemployment tax rates, the current FICA tax rate for employers, as well as reported test year property and ad valorem taxes, the Commission finds that Garden Heights should be allowed, for rate-making purposes, an adjusted expense of \$960 for this account.

#### Rate Case Expense

The ARF procedure was established to provide a simplified and less expensive method for small utilities to present cases before the Commission. The ARF application was designed so that

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<sup>16</sup> Response, Commission's Information Request of October 12, 1984, Item 7.

<sup>17</sup> Response, Commission's Information Request of December 17, 1984, Item 1.

<sup>18</sup> Pages 4-8 of this Order.

the utility should encounter little or no difficulty in presenting its case for an increase in rates. In most instances no legal assistance is necessary. The type of information requested by the Commission in its Orders of October 12 and December 17, 1984, should have been readily available in the offices of Garden Heights and services of an attorney should not have been required in obtaining this information.

It is the opinion of the Commission that a minimal amount of rate case expense should be incurred by a utility under the ARF procedure. Nevertheless, rate case expense has been allocated in previous ARF proceedings when a reasonable basis has been presented by the utility.

In this case Garden Heights provided a statement for \$4,200 from its attorney for rate case charges through November 6, 1984. One-third of this amount was to be allocated to Garden Heights and two-thirds to Gardenside.<sup>19</sup> Additionally, \$400 in accounting fees associated with the rate case had been charged to Garden Heights resulting in a total proposed rate case expense of \$1,800 amortized over 2 years.<sup>20</sup> In response to a Commission request to provide justification for this level of rate case expense, Garden Heights responded, "the legal fees and out of pocket expenses requested to be approved by the Commission for this application as

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<sup>19</sup> Response, Commission's Information Request of October 12, 1984, item 2.

<sup>20</sup> Ibid.



allocated to this sewer division total \$1,000.<sup>21</sup> As the Commission's request specifically dealt with total rate case expense, not just legal, the Commission understands this response to include any accounting fees which may be incurred by Garden Heights as a result of this proceeding. The Commission finds \$1,000 to be a reasonable level of rate case expenses in this instance; however, Garden Heights has provided no persuasive evidence as to why the Commission should deviate from past practice concerning the 3-year amortization period which has generally been utilized in proceedings of this type. Therefore, the Commission has used \$333, \$1,000 amortized over 3 years, for rate-making purposes herein.

After consideration of the aforementioned adjustments, the Commission finds Garden Heights' adjusted test-period operations to be as follows:

	<u>Reported Test Period</u>	<u>Pro forma Adjustments</u>	<u>Adjusted Test Period</u>
Operating Revenues	\$12,387	\$1,013	\$13,400
Operating Expenses	<u>12,991</u>	<u>&lt;104&gt;</u>	<u>12,887</u>
Net Income	<u>&lt;\$604&gt;</u>	<u>\$1,117</u>	<u>\$ 513</u>

#### REVENUE REQUIREMENTS

Though not specifically stated by Garden Heights, its revised application reflects that it is basing its requested increase on a 96.3 percent operating ratio. The Commission

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<sup>21</sup> Response, Commission's Information Request of December 17, 1984, item 2.

typically allows small, privately-owned sewer utilities an after tax operating ratio of 88 percent. The Commission is of the opinion that the operating ratio is a fair, just and reasonable method for determining revenue requirements in this case. The Commission finds that an operating ratio of 88 percent will allow Garden Heights to pay its operating expenses, service its debt, and provide a reasonable return to its owners. The use of this ratio results in Garden Heights requiring additional revenue of \$1,744 over normalized test-year operating revenues and results in an after tax net income of \$1,917.

#### SUMMARY

1. The rate in Appendix A is the fair, just and reasonable rate for Garden Heights and will produce gross annual operating revenue sufficient to pay its operating expenses and provide a reasonable surplus for equity growth.

2. The rate proposed by Garden Heights would produce revenue in excess of that found to be reasonable herein and therefore should be denied upon application of KRS 278.030.

IT IS THEREFORE ORDERED that the rate in Appendix A be and it hereby is approved for services rendered by Garden Heights on and after the date of this Order.

IT IS FURTHER ORDERED that the rate proposed by Garden Heights be and it hereby is denied.

IT IS FURTHER ORDERED that within 30 days of the date of this Order Garden Heights shall file with this Commission its revised tariff sheets setting out the rate approved herein.

Done at Frankfort, Kentucky, this 25th day of March, 1985.

PUBLIC SERVICE COMMISSION

Richard D. Hemmigh  
Chairman

R. H. [Signature]  
Vice Chairman

[Signature]  
Commissioner

ATTEST:

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Secretary

APPENDIX A

APPENDIX TO AN ORDER OF THE PUBLIC SERVICE  
COMMISSION IN CASE NO. 9128 DATED 3/25/85

The following rate is prescribed for customers receiving service from Sargent and Sturgeon Builders, Inc., Garden Heights Subdivision. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of the Commission prior to the effective date of this Order.

CUSTOMER CLASS

MONTHLY RATE

Residential

\$11.00